

Message Text

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ACTION EB-04

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C O N F I D E N T I A L MADRID 1147

LIMDIS/GREENBACK

E.O. 11652: GDS
TAGS: EFIN, SP
SUBJECT: EXCHANGE MARKET DEVELOPMENTS

REF: STATE 029600; MADRID 1145 AND 1146

1. MADRID REFTELS PROVIDE AN OVERVIEW OF THE CURRENT ECONOMIC/
FINANCIAL SITUATION AND THE VIEWS OF THE BANK OF SPAIN'S
DIRECTOR OF RESEARCH. WE ARE WORKING ON A DETAILED REPORT
ON THE 1976 BALANCE OF PAYMENTS OUTCOME, AND ON 1977 AND
ONWARD PROJECTIONS. THESE DETAILED REPORTS WILL BE SUB-
MITTED AS SOON AS POSSIBLE. WE WOULD SIMPLY NOTE HERE THAT
THE 1976 CURRENT ACCOUNT DEFICIT IS ESTIMATED TO HAVE BEEN
BETWEEN \$4.2 AND \$4.3 BILLION, AND THAT IN VIEW OF THE PETROLEUM
PRICE INCREASE OF LATE 1976, LIKELY CONTINUED SPANISH INFLA-
TION IN 1977 AT LEAST AT THE RATE OF 1976, AND SPECULATION
AGAINST THE PESETA IN A VARIETY OF WAYS THE 1977 BALANCE
OF PAYMENTS DEFICIT STANDS TO BE GREATER THAN IN 1976 UNLESS
SOME CORRECTIVE ACTION IS TAKEN.

2. IN THEORY SPAIN COULD FULLY FINANCE A DEFICIT OF \$5
BILLION OR ABOVE IN 1977 THROUGH DRAWING DOWN ITS GOLD AND
FOREIGN EXCHANGE RESERVES OF SOME \$4.9 BILLION AT THE END
OF 1976 AND BORROWING ADDITIONAL AMOUNTS ABROAD ON TOP OF
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ITS CURRENT ESTIMATED \$12 BILLION IN COMBINED SPECIAL AND PRI-
VATE FOREIGN DEBT. IN CONNECTION WITH INCREASED DEBT,
ALTHOUGH COMMERCIAL BANKS ARE SAID TO BE ASKING INCREAS-
INGLY SHARP QUESTIONS ABOUT THE FUTURE, HIGH-LEVEL SOUND-
INGS HAVE BEEN MADE WITH SAUDI ARABIA, KUWAIT AND THE
UNITED ARAB EMIRATES THAT SPAIN HOPES MAY YIELD
\$1.5 TO \$2 BILLION IN 1977. IN PRACTICE, HOWEVER, THE GOS IS

MORE LIKELY TO TAKE SOME ACTION TO LIMIT THE DEFICIT BEFORE 1977 IS OUT THAN TO DEPEND ENTIRELY ON RESERVE DRAWDOWN AND INCREASED BORROWING.

3. THE QUESTIONS ARE, THEN, PRECISELY WHEN THE ACTION WILL BE TAKEN AND WHAT IT WILL BE, NOT WHETHER THERE WILL BE ACTION (SINCE SPAIN HAS NO NORTH SEA PETROLEUM OR OTHER DEU EX MACHINA AVAILABLE TO RESOLVE ITS STRUCTURAL PROBLEMS IN 1977, 1978 OR THE FORESEEABLE FUTURE).

4. EVENTUALLY THERE MUST BE A MAJOR DEPRECIATION OF THE PESETA RATE, EITHER THROUGH PROGRESSIVE FLOAT DOWNWARD OR AN ABRUPT DEVALUATION. HOPEFULLY THAT MAJOR CORRECTION WILL BE ACCOMPANIED BY AN APPROPRIATE STABILIZATION PROGRAM. AS REPORTED IN REFTELS, MANY KNOWLEDGEABLE SPANISH BANKERS, BUSINESSMEN, POLITICIANS AND MEDIA REPRESENTATIVES BELIEVE THAT THE GOS SHOULD HAVE ALREADY EMBARKED ON A STABILIZATION PROGRAM, INCLUDING DEVALUATION, AND ARGUE THAT, NOT HAVING DONE SO, IT SHOULD DO SO BEFORE ELECTIONS. WE CANNOT BE CERTAIN OF GOS THINKING AT THE TOP; BUT ALL THE INDICATIONS WE HAVE THUS FAR ARE, HOWEVER, THAT IT HOPES TO GET THROUGH THE ELECTIONS EXPECTED IN LATE MAY WITHOUT MAJOR ACTION. IT HAS PERMITTED THE PESETA TO DRIFT DOWN SLIGHTLY IN RECENT WEEKS (FROM 68.0 TO THE DOLLAR ON JANUARY 4 TO 68.8 ON FEBRUARY 3) AND MAY CONTINUE TO PERMIT GRADUAL MOVEMENT, BUT DOES NOT PRESENTLY APPEAR INCLINED TO MORE DEFINITIVE ACTION.

5. UNDERSTANDING OF THE BASIC WEAKNESS OF THE PESETA AND
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OF THE INADEQUACY OF GOS ECONOMIC POLICIES THUS FAR IS SUFFICIENTLY WIDESPREAD WITHIN SPAIN SO THAT THE GOS MAY BE FORCED BY A MORE RAPID DETERIORATION OF ITS BALANCE OF PAYMENTS POSITION, TO GO BEYOND PRESENT INTENTIONS BEFORE MAY. WHETHER IT WOULD THEN OPT FOR MORE RESTRICTIONS AND CONTROLS (AND PERHAPS ADVANCE IMPORT DEPOSITS) RATHER THAN A STABILIZATION EFFORT, INCLUDING DEVALUATION OR AT LEAST MORE RAPID DOWNWARD FLOAT AND CREDIT RESTRAINT, IS AN OPEN QUESTION; BUT THE NORM FOR GOVERNMENTS CONCENTRATING ON POLITICS USUALLY IS THE RESTRICTIONS AND CONTROLS ROUTE.

6. IN THIS SITUATION, IT IS FORTUITOUS THAT AN ANNUAL IMF CONSULTATIONS MISSION WILL BE IN MADRID FOR TWO WEEKS BEGINNING FEBRUARY 16. SO FAR AS WE CAN TELL, THE GOS IS PLANNING THUS FAR TO TREAT THE VISIT OF THIS MISSION AS A ROUTINE TECHNICAL MATTER. IT WOULD OBVIOUSLY BE BETTER IF POLICY MAKERS COULD BE BROUGHT TO FOCUS ON ITS FINDINGS. STABLER

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